

Message Text

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ACTION EA-10

INFO OCT-01 IO-10 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

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FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01

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R 150357Z APR 75

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 9419

INFO AMEMBASSY TOKYO

AMEMBASSY TAIPEI

AMCONSUL HONG KONG

USDEL MTN GENEVA

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HONG KONG FOR REGFINATT

E.O. 11652: GDS

TAGS: EFIN, ETRD, KS

SUBJECT: BALANCE OF PAYMENTS SITUATION REMAINS SERIOUS

REF: SEOUL 0947

SUMMARY: SECURING OF FORIEGN EXCHANGE TO FINANCE HUGE
BALANCE OF PAYMENTS DEFICIT, STILL ESTIMATED BY EMBASSY
AT ROUGHLY \$2.4 BILLION, REMAINS KOREA'S PRIME PROBLEM
FOR 1975. NET FOREIGN ASSETS FELL \$473 MILLION IN
FIRST QUARTER AND SOME PROBLEMS NOW BEING EXPERIENCED
IN OPENING LARGE L/C'S FOR OIL IMPORTS. NEXT 5-6
MONTHS WILL PROBABLY BE MOST ACUTE PERIOD BEFORE BOP
DEFICIT NARROWS TO LEVEL OF NET LONG-TERM CAPITAL
INFLOWS. RECOMMEND U.S. HELP THROUGH PL480 SALES
EARLY IN FY 1976, EXIM LOAN APPROVALS ASAP, ENCOURAGEMENT
OF U.S. BANKS TO SEE KOREA THROUGH THIS DIFFICULT PERIOD
AND POSSIBLE APPROACHES TO MIDDLE EAST LENDERS. END SUMMARY
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1. BOP DEFICIT: PRELIMINARY FIRST QUARTER DATA SUPPORT EMBASSY ESTIMATE IN REFTEL OF 1975 BOP CURRENT ACCOUNT DEFICIT OF AROUND \$2.4 BILLION, OR \$1.0 BILLION HIGHER THAN OFFICIAL ESTIMATE. DUE TO UNUSUALLY HIGH IMPORTS, FIRST QUARTER DEFICIT WILL PROBABLY EXCEED \$900 MILLION BUT SECOND QUARTER DEFICIT SHOULD BE AROUND \$700 MILLION. (QUARTERLY CURRENT ACCOUNT DEFICITS IN 1974 INCREASED STEADILY FROM \$357 MILLION IN FIRST QUARTER TO \$557 MILLION IN FOURTH QUARTER.) EXPORTS IN FIRST HALF, SEASONALLY ADJUSTED, WILL APPROXIMATE DEPRESSED SECOND HALF 1974 LEVEL. EXPORT ORDERS WERE PARTICULARLY LOW DURING DECEMBER-FEBRUARY BUT RECOVERED IN MARCH, RAISING HOPES THAT WORST IS OVER. EMBASSY 1975 BOP ESTIMATE ASSUMES EXPORTS IN SECOND HALF, SEASONALLY ADJUSTED, WILL BE 15 PERCENT HIGHER THAN FIRST HALF, YIELDING EXPORT TOTAL ONLY SLIGHTLY ABOVE REVISED 1974 TOTAL OF \$4.54 BILLION. IMPORT INCREASE ASSUMED LIMITED TO ABOUT 10 PERCENT REVISED 1974 FOB IMPORT TOTAL OF \$6.24 BILLION.

2. EXCHANGE RESERVES: HEAVY SHORT-TERM BANK BORROWING CONTINUES TO BE PRINCIPAL MEANS OF FINANCING INCREASE IN BOP GAT. AS RESULT, NET FOREIGN ASSETS FELL \$473 MILLION IN FIRST QUARTER TO MINUS \$623 MILLION. HOWEVER, GREATER USE OF TRADE CREDITS IN MARCH REDUCED MONTHLY DECLINE TO \$90 MILLION. LONG-TERM BANK AND IMF LIABILITIES REMAINED AROUND \$450 MILLION DURING QUARTER. KOREANS DID NOT DRAW SECOND \$100 MILLION OF U.S. BANK LOAN WHICH BECAME AVAILABLE IN LATE FEBRUARY, REPORTEDLY AS CONFIDENCE MOVE. UP TO FULL AMOUNT OF LOAN WILL BE DRAWN IN APRIL. GROSS RESERVES FELL \$176 MILLION IN FIRST QUARTER TO \$873 MILLION. MARCH DECLINE WAS \$40 MILLION.

3. POSSIBLE FX CREDIT PROBLEM: IMPORT REFINANCE BY BANKS (MAINLY U.S.) ROSE \$266 MILLION IN FIRST QUARTER TO \$916 MILLION, EXCEEDING GROSS RESERVES FOR FIRST TIME. IT APPEARS THAT THESE CREDITS, PLUS FOREIGN BANK CREDITS TO TRADERS, MAY BE APPROACHING LIMITS OF LINES CURRENTLY AVAILABLE. INITIAL SYMPTON IS CONFIDENTIAL

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DIFFICULTY IN SECURING NEW SINGLE-BANK CREDITS OF \$10-20 MILLION FOR CRUDE OIL IMPORTS ON 120-DAY BASIS. GULF KOREA HAS WRITTEN LETTER TO MINISTER OF FINANCE REQUESTING ASSISTANCE IN FINDING SOLUTION, SINCE OTHERWISE SOME SHIPMENTS WILL HAVE TO BE CANCELLED. EMBASSY IS FOLLOWING CLOSELY.

4. FINANCING PROSPECTS: NEW SWAP LENDING ARRANGEMENTS

WITH FOREIGN BRANCH BANKS NETTED ABOUT \$25 MILLION IN FIRST QUARTER, AS DID NEW SCHEME TO ATTRACT EURO-DOLLAR DEPOSITS INAUGERATED IN FEBRUARY. ROKG HOPES TO BE ALLOCATED ABOUT SDR 200 MILLION UNDER NEW IMF OIL FACILITY, WITH SDR 60 MILLION (\$75 MILLION) EXPECTED TO BE AVAILABLE IN MAY AND SIMILAR AMOUNT IN SECOND HALF. ROKG ALSO HOPES TO CONCLUDE AGREEMENT FOR USE OF NEW IMF EXTENDED FUND FACILITY, UNDER WHICH AT LEAST HALF OF \$140 MILLION TOTAL CREDIT COULD BE DRAWN IN SECOND HALF. (DISCUSSIONS WERE HELD WITH TUN THIN, IMF DEPARTMENT HEAD, DURING EARLY APRIL VISIT.) VARIOUS MIDDLE EAST POSSIBILITIES ARE BEING ACTIVELY PURSUED BUT SALE OF ADDITIONAL KOREA DEVELOPMENT BANK BONDS APPEARS TO BE ONLY IMMIMENT FUND-RAISER.

5. MEASURES TO REDUCE BOP DEFICIT: SEVERITY AND DURATION OF FX FINANCING PROBLEM DEPENDS NOT ONLY ON EXTERNAL FINANCING AVAILABILITIES BUT ON ROKG MEASURES TO MINIMIZE PROBLEM. KOREANS ARE SUCCESSFULLY PUSHING EXPORTS TO COUNTRIES OTHER THAN U.S. AND JAPAN. WHILE TOTAL EXPORTS IN FIRST TWO MONTHS WERE 10 PERCENT BELOW YEAR EARLIER, EXPORTS TO THESE COUNTRIES ROSE 23 PERCENT AND ACCOUNTED FOR 46 PERCENT OF TOTAL. ON SAME BASIS EXPORTS TO JAPAN WERE DOWN 44 PERCENT AND EXPORTS TO U.S. UP 6 PERCENT. WHILE TIMING AND DEGREE OF ECONOMIC TURNAROUND IN U.S. AND JAPAN REMAIN VERY IMPORTANT FACTORS, THESE TWO MARKETS NOW ACCOUNT FOR 54 PERCENT INSTEAD OF TRADITIONAL 70 PERCENT OF KOREAN EXPORTS AND THEIR RECOVERY WILL SUPPLEMENT THE KOREAN UPTREND IN OTHER MARKETS.

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INFO OCT-01 IO-10 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

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6. KOREANS ARE NOW TRYING TO BRING IMPORTS DOWN THROUGH INCREASED IMPORT DEPOSITS AND ADMINISTRATIVE RESTRAINTS, AFTER FIRST QUARTER BULGE LARGELY REFLECTING INCREASED DOMESTIC ACTIVITY RESULTING FROM STRONG FISCAL STIMULUS WHICH BEGAN IN NOVEMBER. SEASONALLY ADJUSTED INDUSTRIAL PRODUCTION ROSE 13.3 PERCENT FROM OCTOBER LOW TO NEW PEAK IN JANUARY. IN FEBRUARY INDEX FELL 0.4 PERCENT AND WAS 5.7 PERCENT ABOVE YEAR EARLIER. WHILE AVOIDANCE OF LARGE-SCALE UNEMPLOYMENT REMAINS PRIME POLITICAL CONCERN, KOREAN ECONOMIC OFFICIALS ARE TALKING OF NEED FOR GREATER FISCAL AND MONETARY RESTRAINT IN VIEW OF BOP DEFICIT. INCREASES IN CONSUMER GRAIN AND FERTILIZER PRICES, TO REDUCE LARGE GOVERNMENT SUBSIDIES, HAVE BEEN RECOMMENDED BUT NOT ADOPTED FOR POLITICAL REASONS SO FAR.

7. KOREAN STRATEGY FOR 1975 HAS BEEN BASED ON ASSUMPTION OF STRONG EXPORT UPTURN IN SECOND HALF, PERMITTING SHIFT TO NEUTRAL OR EVEN DEFLATIONARY FISCAL AND MONETARY POLICIES. BUDGET SPENDING PROGRAM HAS BEEN FRONT-LOADED AND PROPOSED IMF STANDBY AGREEMENT
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ALLOWS 23.4 PERCENT INCREASE IN DOMESTIC CREDIT IN FIRST HALF BUT ONLY 31.2 PERCENT FOR ENTIRE YEAR. UNLESS THERE IS UNEXPECTED BOOM IN EXPORT ORDERS, THIS CALCULATED RISK WILL SHORTLY HAVE TO BE REASSESSED IN LIGHT OF CONFLICTING PRESSURES TO AVOID UNEMPLOYMENT AND REDUCE IMPORTS FOR DOMESTIC CONSUMPTION.

8. SHORT TERM FX PROBLEM: ON ASSUMPTIONS OF MODERATE EXPORT UPTREND AND IMPORT RESTRAINT WE FORESEE PROGRESSIVE NARROWING OF BOP CURRENT ACCOUNT DEFICIT, E.G. FROM ABOUT \$770 MILLION IN SECOND QUARTER TO ABOUT \$500 AND \$300 MILLION IN THIRD AND FOURTH QUARTERS. SINCE WE ESTIMATE NET LONG-TERM CAPITAL ARRIVALS WILL AVERAGE ABOUT \$400 MILLION PER QUARTER IN 1975, KOREA'S FX PROBLEMS SHOULD END ABOUT SEPTEMBER, IF EXPORTS INCREASE. THUS PROBLEM IS ONE OF FINDING ADEQUATE CASH FINANCING FOR NEXT 5-6 MONTHS AND, IN VIEW NET FX LIABILITY POSITION, FOREIGN LENDER CONFIDENCE WILL BE KEY FACTOR. KOREANS

HOPE TO SECURE LARGE MIDDLE EAST LOAN, WHICH WOULD BE MOST HELPFUL, BUT IN PRACTICE THEY WILL PROBABLY BE FORCED TO TRY TO SQUEAK THROUGH WITH REMAINDER OF U.S. BANK LOAN, FIRST TRANCHE OF IMF OIL FACILITY, ADDITIONAL SWAP CREDITS AND FOREIGN DEPOSITS, FURTHER STRETCHING OUT OF CREDUE TERMS AND POSSIBLE KDB BOND SALES.

9. RECOMMENDATIONS: SINCE OUR ANALYSIS IS ESSENTIALLY UNCHANGED, OUR RECOMMENDATIONS REMAIN SIMILAR TO THOSE IN EARLIER MESSAGES: AS MUCH PL480 AS SOON AS POSSIBLE IN FY 1976; EARLY APPROVALS OF PENDING EXIM LOAN APPLICATIONS, TO HELP MAINTAIN INVESTOR LENDER CONFIDENCE; SUPPORT OF KOREAN REQUESTS FOR IMF CREDITS; \$1 BILLION IN LONG - AND SHORT-TERM CREDITS IN PAST 15 MONTHS, TO SEE KOREA THROUGH WHAT APPEARS TO BE REMAINING LIMITED PERIOD OF FX DIFFICULTIES; CONSIDERATION OF POSSIBLE USG GUARANTIES FOR COMMERCIAL AND BANK BORROWING BY HARD-HIT MIDDLE ECONOMIES SUCH AS KOREA; AND POSSIBLE APPROACHES TO MIDDLE EAST LENDERS RE LOANS TO KOREA. IN ADDITION THE CONSULTATIVE GROUP MEETING, SCHEDULED FOR JULY 1-3 IN PARIS, SHOULD BE USED TO EXAMINE APPROPRIATENESS OF KOREAN ECONOMIC

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POLICIES IN LIGHT OF PREVAILING CONDITIONS AND OUTLOOK.
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